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HUMAN SETTLEMENTS FINANCING MECHANISMS

(in relation with the setting up of housing financing institutions)

M82-628

INTRODUCTION

1. Inadequate provision of finance appears to set a limit beyond which little could be achieved in human settlements development. This seems true inasmuch as virtually all known solutions to human settlements problems could be implemented once the right type and amount of money is available. However financial resources are scarce in Africa disproportionately distributed over the region and compete for several sectoral demands. The result is that housing although a basic requirement, is never adequately catered for financially.

2. Within the housing sector itself finance is required for the development of building materials, purchase of land, construction machinery and equipment as well as training of skills. The demand for money to purchase a housing unit as such, represents only an end demand. It appears therefore that financial resources for housing in Africa are over strained; on the other hand the failure to project financial requirements from a comprehensive approach has been a basic cause of failure of several housing financing programmes.

3. Apart from a few rich countries the provision of finance for housing in Africa has mainly been that of individual efforts. Perhaps it should be mentioned from the start that no individual African government can afford to house adequately, its population from public revenue. Institutional housing finance should, therefore, be regarded as a necessary supplement to individual efforts. In this regard, housing financing institutions are needed as legally recognized establishments through which parts of long term savings and any other accumulated funds could be channelled for investment into housing. However, the establishment of such financing institutions should not put additional strains on sources of finance that are already over burdened.

4. Post independence Africa has witnessed the establishment of several housing financing institutions particularly at the national level. Some of these institutions have made little impact on the national housing situation while others are dormant due to inadequate operating funds. To the extent that institutional financing could play an increasing role in housing development it becomes necessary for African governments to re-examine the present practice as a guide for future action.

Scope and coverage

5. The paper is divided into three parts (excluding the introduction). Part one examines briefly the present practice of institutional housing finance and the related problems. Part two discusses possible sources of fund and their effective re-allocation among competing uses within the housing sector itself while Part three generally recommends areas for action.

6. The paper does not however, cover two important areas of housing finance nakely: rural housing and international sources of housing finance. In addition details of housing finance administration are avoided while potential sources of funds which currently constitute regular sources of public revenue are excluded.

7. Finally, the paper does not examine the contribution that could be made from indirect sources such as reduced house building costs through research, building material substitution and increased productivity. It is assumed that such gains cannot be physically channelled into housing financing institution.

3. The paper therefore concentrates only on sources of funds such as pensions and social security savings which are usually not committed statutorily to any specific end uses as well as the vital contribution that could be made by individual contributions from the organized sector.

SUMMARY

9. All African governments realize the need to establish financing institutions for housing development, however, their attention has often been diverted to the immediate needs from other sectors. This factor is further emphasized by the fact that certain vital areas of the housing sector such as building materials industries finance and essential services often constitute parts of other ministries. Such administrative structures do not often function in the best interest of the housing sector.

10. However, what is deemed most lacking is the presence of any statutory legislation on the use of parts of long term savings for housing development. The paper is of the opinion that parts of social security, pensions and similar other funds could be suitably invested into the housing sector without adversely affecting other public programmes.

11. Further, in order not to disrupt public programmes from other sectors, the paper strongly suggests that finance for housing should be sought from those sources that are presently not over-utilized or else are not meant for any specific and immediate uses.

12. It is also recommended that all African governments should provide the necessary statutory legislation for parts of the above funds to be utilized for the establishment of housing financing institutions. Each country should however, examine which of the suggested sources would be most suitable for its conditions.

13. The paper strongly recommends the introduction of "housing cess" by every government since the proceeds from this source could be specifically reserved for the housing sector.

14. The paper also argues that in some African countries housing financing institutions do not follow any systematic development programmes nor do they effectively analyze all the priority areas that require funding in order to promote a smooth housing programme. The paper suggests that the development of systematic programmes and analysis of priority areas of funding should constitute functions of such financing institutions.

15. In line with the above, each government should also legally control the proportionate allocation of funds so as to eliminate obvious development bottlenecks in housing. Thus, building materials industries development/rehabilitation, contractor prefinancing and the establishment of plant pools should constitute inevitable areas of institutional housing financing.

PART ONE

Present practice of institutional housing financing

16. Most housing banks in Africa were established with public funds (although commercial banks and insurance companies often hold shares). Regardless of the sources of funds, the primary fact is that a fixed financial capital is often provided to be traded by the established company.

17. For a financial institution, financial solvency and profitability constitute primary objectives. This underlines the practice of lending to the section of the population that could afford to build its own house to the neglect of those who are really in need of financial assistance. The same issue explains the practice of spatial discrimination as regards the location of the estate to be financed with institutional loans. Cities and urban settlements increase the value of landed property and hence the reluctance to assist deserving customers in rural locations.

18. It has often been argued also that the supply of capital funds for long-term use at comparatively low yield is a principal limiting factor which badly affects the production of adequate housing and related facilities in African countries. The above situation has however changed in some of the countries where interest on housing loans are at par with those on commercial undertakings. In some countries, these are as high as 13 per cent per annum. 1/ Interest rates in most African countries are fixed by the government and are manipulated as an inflation control measure to regulate the volume of money in circulation. If high interest rates in practice discourage borrowing, then such a monetary tool should be regarded as a negative policy which could curtail financial supply to a sector which already does not attract adequate funding.

19. A final common characteristic of housing loan administration in Africa is the practice of the financing institution calling for a surety, usually a fixed asset as security against loans. The result is that those who already own houses have the advantage of obtaining loans to build more houses. The majority of the African population therefore, has no easy access to institutional housing loans. And yet in the presence of these stringent measures, no housing financing institution in Africa has ever been able to meet the requirements of all prospective customers, on the contrary, most of these banks have had little or no impact on the housing situation while others are operationally inactive. The courses of failure are inborn in the nature of establishment and mode of administration.

Causes of inactivity and failure

20. A primary factor which requires attention in the establishment of housing financing institutions is the use of fixed capital. Housing constitutes a fairly long term investment. Monies loaned out to finance housing, therefore, have repayment periods ranging between five to twenty years. This is the very opposite of commercial banking where most loans are repaid within nine months' time.

1/ A system of multiple interest rates is practiced in some African countries. Niger, for example, administers three types of rates depending upon the type of house to be built and the volume of loan required.

21. For example, $5000 loaned out for a housing project could be repaid (on equal installment terms) within eight years period with one year moratorium on principal repayment only. This implies that (assuming a 7 per cent interest per annum) only $350, constituting the interest, could be recovered at the end of the first year, it also implies that while the total repayment would be completed after nine years (assuming no leakage) 2/ the next applicant would obtain his loan eight years after the initial lending has been made. At the end of the ninth year, total repayment comes to only $7,185 with two beneficiaries.

22. The same amount of money given to commercial banking could be reloaned eleven times yielding a total payment of $10,518 (assuming no leakage and accepting the repayment period stated in paragraph 20). It is conclusive, therefore, that unless the initial capital provided to housing financing institutions is substantial and supplied on a regular basis financing would become dormant shortly after the establishment of the bank. There is therefore, the need to determine the volume of capital that could operate an active housing financing institution.

23. Quite often, mortgage loan scheduling does not make room for leakages that could occur during the period of repayment. The example cited earlier assumes that after the one year moratorium, construction would be completed and loan repayment would be regular over the next eight years. But this does not pertain in practice.

24. In Africa, leakages result mainly due to frequent shortages of building materials, construction problems, as well as price escalations which may necessitate the provision of supplementary loans. These do not take into account dishonest practice on the part of the client or the builder through diverting part of the money for other uses. The result is that most often, there are leakages and repayment is never on schedule. There are examples of housing projects which have remained uncompleted for more than five years thus locking up all the loan capital.

25. Such leakages not only embarass customers, but also impair the lending ability of the institution. Quite often, housing financing institutions run out of loanable funds as a result of such leakages. The next question then is how could the occurrence of such leakages be minimized so as to keep housing financing institutions financially active.

26. A third problem which requires attention in the establishment and administration of housing financing institutions in Africa pertains to a number of interrelated problems, for example: who caters for the low income group which has no securities? As mentioned earlier, financial solvency and profitability are inevitable requirements of housing banks. Such institution would, therefore, naturally provide loans to customers whose rent capacities are not unduly low.

27. It would be noted however, that on the average, 72 per cent of the working population in most African countries share below 50 per cent of the national income. Statistical information about per capita income is very scarce in most African

2/ Leakage in this context implies that there are repayment defaults and that all of the loaned sums do not find their way back into the banking system.

countries, however, the estimated average per capita income for the region is about US$175.8 3/ (excluding the oil producing countries). There is therefore, the need for a financing mechanism that could benefit the low income group which are genuinely deserving.

28. The next problem is how institutional financing could be extended to the rural population and yet minimize the lending risk of the institutions. Although Africa is experiencing a rapid rate of urban growth, about 80 per cent of the region's population still lives in rural areas. It is estimated that between 1960 1970 alone some 40 million dwellings were required to meet expected population increases in rural Africa. In addition, although urban incomes are low, they are almost six times higher than rural incomes. 4/

29. Such disparities between rural and urban incomes compel financial institutions to place restrictions on mortgage loans in rural areas. However a strict adherence to such a rule (although logical) would mean denying financial assistance to the majority of the population. 5/

30. It would be inferred from the above that although the idea of establishing housing financing institutions in Africa is laudable, most attempts have met with little success. Apart from numerous administrative problems, the chances of leakage remain very ripe and could spell the failure of several of such institutions. There is also the problem of the financial facility not benefitting the really deserving sections of the population, and above all the number of beneficiaries is small (perhaps due to the volume of money spent on individual projects) with the result that the banks do not appear to have any appreciable impact on the housing scene in most African countries. These experiences are valuable and should provide lessons for the establishment of human settlements financing mechanisms in the region.

PART TWO

Lessons for the future

31. The fact that certain African countries do not still have any special banks to finance housing indicates that the practice of institutional housing financing is comparatively recent in the region. Any breakthrough in the future should, therefore, depend upon a re-examination of the experiences that are typical of the region. In particular the following subjects should require attention:

- volume, source and nature of funds,
- priority areas in funding,
- income levels, securities and eligibility for loans.

3/ Human Settlements in Africa, ECA Addis Ababa, 1976.

4/ E/CN.14/HOU/76 ECA.

5/ The subject of rural housing finance needs a detailed study by itself and hence not examined in this paper.

32. As explained earlier, housing is an expensive and long term investment asset. Thus due to the slow rate of turn over of housing finance, the volume of money required to establish a housing financing institution should be reasonably substantial if only the institution is to make any impact.

33. It is difficult to state how much capital is required for the establishment of such an institution. It is estimated however, that to meet only the demographic housing needs of the urban areas, between 5.9 and 6.5 per cent of total urban income would be needed for investment. 6/ This excludes the costs of land and services. For the region as a whole, between 7 to 10 per cent of national income may have to be spent on house construction (including land, services, replacement, rural and other needs). While such figures are based upon several assumptions, 7/ they clearly indicate that the task of housing the entire African population is formidable.

34. It is estimated that most African countries develop, on the average two houses (per thousand population), per annum. For a country with 10 million population, this implies the completion of about 20 thousand houses every year. Although, this falls below the recommended UN rate of 10 houses per 1,000 population, it represents a worthy effort mostly on the part of individual developers in the region. What remains is for financial institutions to supplement the individual efforts through the development of local building materials industries, increasing construction capacity and providing direct financial assistance to deserving customers.

35. The fact to note however, is that the primary step in successfully operating a housing financing institution does not depend only upon providing loans to customers. More than anything else, much depends upon an effective assessment of the local building material position, and local construction capacity on the one hand and the regularity as well as volume of loanable funds on the other. Any imbalance between these two areas would generate bottlenecks in the system.

36. It should be emphasized therefore, that for the successful operation of a housing bank, a substantial amount of development fund is required on a regular basis. This will ensure (a) that building materials are readily available, (b) the construction capacity is efficient and sufficient to execute projects and (c) there are funds to meet other requirements of customers such as payments to contractors, provision of services, access ways, etc. The basic function of the housing bank then, is to provide the financial priming for all or part of the above requirements. The obvious question then is which sources of funds are suitable for such operations?

37. Usually, funds from the central banks, pension and social security as well as life insurance schemes have been recommended. However, depending upon the economic situation in each country, these sources of funds would have competing uses.

6/ Refer to E/CN.14/HOU/22.

7/ The estimates do not take into account dispartities in GDP of the individual countries.

38. For example, it could be questioned whether in a country facing high inflationary problems, it would be advisable for the central bank to pump such huge sums of money into the system annually. In most countries also, social security and pension funds are often used for deficit-financing. Since such uses involve current budget issues, most governments are reluctant to formally commit any fixed proportion of the said contributions for investment into housing.

39. In some African countries also, special institutions have been established to collect and administer pension funds. In certain instances, the administrators have found it more profitable to use such funds for the establishment of commercial banks, or to purchase treasury bills or else to develop a few housing estates for rental purposes. Invariably, uses such as the above only appraise the immediate returns that the funds could yield to the neglect of long term gains from the housing sector.

40. Insurance premiums (particularly, life insurace) could constitute another source of fund for such financing institutions. Quite often, however, insurance companies maintain their own closed schemes to the benefit of their customers. Investments in such schemes have traditionally been made in high income residential buildings. In addition, most tax revenues acruing from the housing sector are usually not ploughed back into housing development. They constitute part of the regular public revenue acruing from taxation.

41. These difficulties, among others, explain why most governments prefer the practice of providng a fixed capital to be traded by such housing financing institutions regardless of the shortcomings. However, countries such as Brazil, which have made remarkable progress in housing development in recent times, take advantage of monies acruing from regular social security contributions.

42. African governments should recognize the fact that investment into housing has several multiplier effects on almost every sector of the national economy. A regular supply of funds for housing development could therefore, favourably stimulate other productive sectors of the economy; such funds could be reclaimed not only directly through repayments but also indirectly through increased tax payments from other sectors, increased productivity attributable to good housing, and increased employment avenues generated in other sectors. It could therefore, be argued that although there are several potential sources of suitable funds that could be used in establishing housing financing institutions, the funds are invariably used or invested elsewhere with emphasis on immediate gains. What therefore, remains to be done is for African governments to give statutory approval for the provision, on annual basis, of a fixed percentage of any of the following funds for investment into housing through established housing financing institutions:

- Social security/pension funds;
- Long term insurance funds;
- Fixed time deposits of commercial banks;
- Annual profits of commercial banks;
- Government bonds (for private subscription)

The point to emphasis is that the above sources are not unknown; however, there are no government legislations compelling the administrators of the said funds to pay any fixed portions into housing banks. It is strongly recommended that each government should allocate a certain percentage of such funds for investment into housing.

Housing Cess[8/]

43. A major problem which confronts housing authorities all over the region is the practice whereby some very vital subsectors of the housing sector fall within the jurisdiction of other ministries. For example, building materials fall under industries ministry, housing finance under ministry of finance/ planning, while the ministry of works and power may be responsible for essential services such as water, sewerage, access ways, electricity and the like.

44. The result is that housing authorities do not have any co-ordinated and balanced control over planning the requirements of their sector. Invariably, the other sectors may not accord enough emphasis to those subsectors as would be needed to make the required impact on the housing sector. An example of the above practice is evident in the inadequate provision of finance for housing.

45. As explained earlier, the potential sources of long term savings that are suitable for investment into housing fall under different authorities (such as commercial banks, insurance companies, and authorities which administer pensions and social security funds). These are not obliged to allocate any portion of the funds to housing. These authorities may have their own areas of priority for investment. Ironically, control over housing banks (even where they exist) often falls under finance ministries rather than housing authorities.

46. Under circumstances such as the above, it becomes necessary for housing authorities to exploit other avenues of finance that could be controlled and utilized solely by the housing sector. In this regard, individual contributions promise to be the most fruitful and less controversial.

47. It is strongly suggested that since housing is a basic necessity to life, housing authorities should take advantage of individual aspirations to own a house to introduce a form of housing tax from personal incomes. Such proceeds could be placed under a special "housing cess", so as to distinguish it from other tax revenues accruing to the government and ensuring its utilization for housing development. The responsibility will be for the housing ministry to control its chanelling into housing.

48. Some African countries have already taken the initiative in this direction. For example, in Togo, there is the Fonds National de l'Habitat to which workers contribute; railway workers in the Sudan contribute towards a special housing and transport fund organized by the trade unions. There is however, no information as to how effectively the revenue accruing from the above sources is utilized.

49. It is therefore, suggested that housing ministries should insist upon their governments for the introduction of the "housing cess". Nevertheless, since in most African countries, workers have almost reached their maximum taxable capacity, the percentage tax for the proposed "housing cess" should not exceed 2.5 per cent of gross salary incomes.

8/ The uses of "Cess" is stressed here in order to restrict the use of the proceeds to the housing sector.

Estimated volume of funds

50. It is not possible to estimate the volume of funds that could possibly accrue from the sources discussed in this paper due mainly to unavailability of required data. However, for purposes of illustration it is assumed that for a particular country, gross annual salary payments in the organized sector could amount to about $200 millions. Based upon this assumption, the following sums could be available for investment into housing through established financing institutions, (if the suggestions made earlier are followed).

Table 1: Estimated Funds

Source	% Contribution		Total		Housing Fund
	Worker	Employer	$ Million	%	m. per annum
Social security and Pension Fund	5	12	34	20	6.8
Housing Cess	2.5	-	5	100	5.00
Other sources *	-		-	100	11.08
Total	-	-	-	-	23.6

* These include parts or all sources mentioned under paragraph 41.

51. It would be noticed that although the percentage contributions are moderate, (varying between 2.5 per cent to 5 per cent of gross income per worker) the total annual contribution could be enormous; this could make a realistic impact on the housing sector, including the development of building materials.

Generating a revolving fund

52. A critical stage in the administration of a housing financing institution is the level at which total repayments are sufficient to meet development targets set by the institution. For example, if after a certain year, total loan repayments are sufficient for reloaning to customers for the development of the 5,080 houses estimated in Table II, it could be said that a revolving fund is generated. While this implies that the number of houses to be developed per year (as well as the number of beneficiaries) is fixed, it emphasizes the fact that the institution pursues a systematic development and lending programme. To a housing financing institution, this should be regarded as a form of break even point.

53. Most housing financing institutions are not able to generate revolving funds because of their failure to follow any systematic programmes and also due to the fact that they do not analyze effectively all the areas which constitute priority subsectors for funding.

54. The occurrence of leakage, capital lock up and resultant inactivity of financing institutions could result from several factors. In housing, however, the main cause is the delay in project completion. The latter results, among others, from unavailability of building materials on the one hand, and inadequate construction capacity on the other 9/. While these two factors would not be discussed in this paper, it is important to point out that most housing banks in Africa become inactive because of their failure to effectively analyze the building materials position and local construction capacity before advancing loans to customers. The result is that most houses are left uncompleted because there are no building materials or else the contractor is ill-equipped to complete the project.

55. The direct implication is that the development of building materials, the establishment of plant pools and contractor pre-financing should constitute part of the financing activity of housing banks in Africa. It is therefore, suggested that at least 40 per cent of the sums paid to such banks from regular sources suggested earlier (see Table I), should be allocated to the following uses according to the percentages suggested.

- Development of new local building materials industries	40%
- Provision of operating capital to the above industries	10%
- Provision of supplementary/rehabilitation loa-s to old building materials industries	15%
- Establishment of plant-pool	30%
- Provision of prefinancing facilities to deserving contractors	5%

The above five areas of expenditure constitute inevitable factors of any housing development programme and as well as vital areas which could contribute to minimize delays in the completion of housing projects. The proposed percentage allocations are presented in Table II as follows:

Table II: Sectoral Disbursement (at Institutional Level)

Amount in $m.	Building materials		Total for housing	No. of houses at $2,000/houses p.a.
	%	$m	$m	
* 23.6	40	9.44	14.16	5,080

* The total sum of US$23.6 millions estimated under Table I equals 100 per cent for the present Table.

9/ Changes in government policy could also adversely affect project completion in the housing sector.

Income levels and eligibility for loans

56. Another factor which requires the attention of African governments with regards to institutional financing of housing relates to income levels. As mentioned earlier, financial solvency and profitability are inevitable requirements of housing banks. Such institutions would therefore, naturally provide loans to customers whose rent cap-cities are not too low. However, the majority of the African population earn rather low incomes and cannot afford to pay economic rents. And yet the low income group actually represents that segment of the population which is genuinely in need of financial assistance to build houses.

57. Another practical financing mechanism for low income groups could be the development of a tripartite consortium financing system involving the government, the employer and financial institutions. Under such a system, the government should develop the necessary infrastructure in the form of roads, drainage, sewerage, water and electricity to the housing project site. The employers should contribute part of their profits as initial deposit for the project while the financing institution provides the remaining amount as loan. It would be observed that in some African countries such as Ghana, employers are obliged by law to pay rent subsidies to their employees. However, since these payments are thinly distributed among individual workers, they do not contribute to increase the housing stock; rather they help to increase prevailing rents.

58. The proposed tripartite financing system could prove very valuable to most African countries if rent subsidies such as discussed above are chanelled into a housing bank and utilized to increase the housing stock. One factor which should be noted is that the contribution from employers could always improve employer-employee relationship, labour stability and higher productivity.

59. However, a major problem which could be foreseen in such a system of financing relates to ownership and administration. A question to be answered is whether the house belongs to the occupant or employer? Given the probability of job instability and mobility of labour, which party takes precedence over the estate? These are problems which could readily be solved through appropriate statutory legislation.

PART THREE

Guidelines for future actions

60. Most African governments realize the valuable role that institutional financing could play in housing development. However, attempts at establishing such institutions have not met with much success in most countries. Some of these institutions are either dormant, short of loanable funds or have made no appreciable impact on the housing scene except in name.

Such experiences however, provide valuable lessons for future action. It should be stated that any successful evolution of human settlements financing mechanisms in future would depend largely on effective statutory backing. Present experiences seem to indicate that while African governments are not unaware of what action to take most of them are reluctant to provide the necessary legal backing because of competing demands. It is therefore suggested that all African governments should examine and adopt the following recommendations as primary steps towards establishing financing mechanisms for human settlements.

- It is insufficient for governments to establish housing financing institutions based on fixed financial capital. Annual allocations are inevitable until such a time that a revolving fund is generated through loan repayments.

- In view of the competing demands for public revenue, African governments should give statutory backing for a reasonable percentage of social security fund contributions to be chanelled to such financing institutions for housing development.

- Inasmuch as low income workers are involved, assistance from their employers will be crucial to increase their rent capacities as well as offering the required securities for institutional loans. African governments should therefore encourage employers to contribute a part of their annual profits towards the provision of housing for their employees.

- Individual contributions, however, appear to be the most promising and less controversial source of finance for housing financing in Africa. The establishment of a housing cess derived from individual incomes is therefore recommended.

- In order to minimize the problem of delays in project completion and leakages in the financing system, the development of building materials; establishment of plant pools as well as contractor prefinancing should qualify for housing financing loans. In light of the above, housing financing institutions should allocate a fixed percentage of their annual investment capital for assistance to building materials industries and local construction firms.

- The use of parts of the accumulated profits of commercial banks for housing purposes should also be considered by every government. As much as possible, such funds should play leading roles in the establishment of building materials industries and plant-pools.

CONCLUSION

61. Several factors inhibit the successful functioning of human settlements financing mechanisms which are practiced in Africa. The most important pertain to the fact that insufficient funds are allocated for the housing sector due mainly to requirements from other competing sectors of the economy.

62. However, a more potent factor which cripples attempts at developing innovative human settlement financing mechanisms in the region relates to the fact that housing authorities do not traditionally have sufficient control over the sources of funds that could be suitably invested into housing. In addition, the most vital subsectors of housing, particularly building materials, land, and finance are usually not put together under housing authorities but rather divided among different ministries. The effect is that in most countries insufficient attention is paid to housing financing when examined as a unified sector.

63. Probably, an effective way to overcome the difficulties relating to housing financing is through effective government legislation so promulgated as to channel parts of long term savings as well as portions of accumulated profits of commercial banks for the development of the human settlements sector.

64. A rather promising source of less controversial fund is individual contribution termed in this paper as "housing cess". This source of fund has three main advantages, namely, convenience of collection, regularity of supply and the possibility of securing its use solely for the housing sector. Housing authorities are urged to recommend to their governments to consider the possibility of introducing this system as well as the appropriate ways of its administration.

65. What should not be overlooked, however, is the need for statutory legislation which could provide the necessary legal backing for any of the financing mechanisms that might be adopted by any government.